THE LAW SOCIETY
OF NEW SOUTH WALES

Our ref: BLC:EElb1690241

20 May 2019

Nathania Nero
Senior Policy Adviser
Consumer and Corporations Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ESSreforms@treasury.gov.au

Dear Ms Nero,

Employee Share Schemes – Consultation Paper

The Law Society of NSW appreciates the opportunity to comment on the 'Employee Share Schemes' Consultation Paper. The Law Society's Business Law Committee contributed to this submission.

General

Employee share schemes ("ESS") are vital to Australian companies being able to attract and retain talent in a highly competitive environment. They align the interests of employers and employees in greatly increased productivity, which delivers benefits in terms of growing taxable wealth and sharing that wealth between employers and employees. ESS encourage employees to invest in a company where they know more about the company and may have some influence, which is arguably a safer investment than other shares.

However, the complexity of the taxation position is a major deterrent for both parties. There are two fundamental misconceptions driving the current system. The first is that tax revenue is being lost unless tax is collected at the time of the benefit vesting rather than when a benefit is exercised. Tax collection is merely delayed, rather than lost. The second is that the ESS will be used regardless of the way the system is structured, which we suggest is not true. If the scheme burdens employees from a tax perspective, then they will not pursue the opportunity to participate and so the commercial rationale for ESS is defeated.

Our responses to some of the specific questions in the Consultation Paper are set out below.

Consultation Paper

1.1 Do you support consolidating and simplifying the statutory exemptions and ASIC Class Order [CO 14/1001] in the Corporations Act?

Yes, we support consolidating and simplifying the statutory exemptions and ASIC Class Order [CO 14/1001] in the Corporations Act.

1.2 Does the complexity of the current regulatory framework for ESSs create significant difficulties for businesses looking to offer an ESS?

Yes, the complexity of the current regulatory framework for ESS creates significant difficulties for businesses looking to offer an ESS. The current regulatory framework acts as a deterrent to many businesses even considering implementing an ESS.

1.3 Would there be significant benefits or risks for business in consolidating and simplifying the current regulatory regime?

Yes, there would be significant benefits for business in consolidating and simplifying the current regulatory regime. A simple system means employers are more likely to offer an ESS.

As set out below, we further recommend reviewing the tax treatment of ESS in conjunction with the Corporations Act review, as part of the complexity of ESS stems from the taxation treatment.

Our view is that there are no material risks for consolidating and simplifying the current regulatory regime. There is sufficient flexibility for businesses offering ESS by the terms of the Employee Share Option Plan ("ESOP").

1.4 Would compliance be significantly easier if the obligations applying to ESSs were all contained in the Corporations Act?

Yes, compliance would be significantly easier if the obligations applying to ESS were all contained in one section of the Corporations Act. It makes compliance easier as employers/advisors only need to look at one piece of legislation.

2.1 Do you support increasing the offer cap per employee?

Yes, this is beneficial. It could increase to $15,000 as for share purchase plans for listed companies.

2.2 What are the benefits or risks of increasing the employee offer cap?

If the cap is not increased regularly (preferably every year), it is no longer an attractive option for employees. As the cost of living and inflation increases every year, the cap equally should increase to match the general increase of costs all around.

The risks associated with increasing the cap are minimal as the option to issue shares under an ESS is usually contained in the terms of the ESOP and the total number of shares and value for those shares is adjusted in accordance with the value of the company at the time the shares are issued.

2.3 Is a $10,000 limit per employee per year appropriate or is a greater increase appropriate?

It could increase to $15,000 as for share purchase plans for listed companies.

6.1 Are there any other regulatory barriers to small businesses offering ESSs?
6.2 Are there any other reforms to the regulatory framework for ESSs that would further facilitate or reduce costs for small businesses offering an ESS?

The Government has acknowledged that the current regulatory framework for EES is "... complex and fragmented, increasing the time and cost associated with offering ESSs" and ultimately discourages some businesses from offering ESS, especially small businesses.

The whole ESS system needs review. While the proposed changes improve the current system, we suggest holistic review is warranted.

The current taxing point means that workers ordinarily pay tax on the value of the shares they are issued, even though it will be years before shares are sold and gains realised in most cases. Further, the rules that do allow deferral, which relate to risk of forfeiture, are complex and not well understood.

The deferred taxing point for options (and for other rights) should be moved to the exercise date of the options (the date they are converted).

The deferred taxing point should be focused on exercising rather than vesting, that is, the taxing point should match when cash can be realised, for example, in the event of an exit such as a trade sale of the business or initial public offering.

The taxation law around ESS is too complex, from the valuation process, to conflicts throughout the tax law on the issue whether it be FBT, buyback rules, Division 7A (deemed dividend rules), general CGT rules, to anti avoidance rules and value shifting rules. Different departments even within the ATO differ in their view of such basic issues.

If you have any questions about this submission, please contact Liza Booth, Principal Policy Lawyer, at liza.booth@lawsociety.com.au or on (02) 9926 0202.

Yours faithfully,

Elizabeth Espinosa,
President